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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1958

No. 843

BHART BROS., a corporation,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals
for the Ninth Circuit.

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UNITED STATES OF AMERICA,
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PETITION FOR A WRIT OF CERTIORARI
to the United States Court of Appeals for the Ninth Circuit.

Bidart Bros., a corporation, respectfully prays for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered January 7, 1959, in Case No. 15,950.

OPINIONS BELOW.

The opinion of the United States Court of Appeals appears in 262 Fed. 2d 607. The opinion of the District Court, Southern District of California, Northern Division, appears in 157 F. Supp., p. 373. It was rendered December 26, 1957. Formal judgment was entered January 9, 1958. Both opinions appear in the appendix to this petition.

JURISDICTION.

The opinion [48] and judgment of the Ninth Circuit was dated and entered January 7, 1959 [42]. A petition for rehearing was timely filed on January 27, 1959, and denied February 17, 1959 [49]. Jurisdiction of this Court is invoked under 28 USC, §1254(1), authorizing this Court to review the judgment of the Circuit Court of Appeals by Writ of Certiorari.

QUESTION PRESENTED.

Whether a sale of unharvested crops grown on leased land held for more than six months, when sold with the Lessee's estate in the land to one and the same person and at the same time, is entitled to be treated as a capital gain rather than as ordinary income, under the Internal Revenue laws of the United States of America, in force and effect between May 1, 1951, and April 30, 1952.

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code of 1939:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * * * *

(j) [As added by Sec. 151(b), Revenue Act of 1942, c. 619, 56 Stat. 798, and amended by Sec. 127, Revenue Act of 1943, c. 63, 58 Stat. 21, Sec. 210(b), Revenue Act of 1950, c. 994, 64 Stat. 906, and Secs. 323, 324 and 325, Revenue Act of 1951, c. 521, 65 Stat. 452] *Gains and Losses from Involuntary Conversion and from the Sale or Exchange of Certain Property Used in the Trade or Business.*

(1) *Definition of property used in the trade or business.* For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or (C) a copyright, a literary, musical, or artistic composition, or similar property, held by a taxpayer described in subsection (j) (1) (C). Such term also includes timber, coal with respect to which subsection (k) (1) or (2) is applicable and unharvested crops to which paragraph (3) is applicable. Such term also includes livestock, regardless of age, held

by the taxpayer for draft, breeding, or dairy purposes, and held for him for 12 months or more from the date of acquisition. Such term does not include poultry.

(2) *General rule.* If, during the taxable year, the recognized gains upon sales or exchanges or property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion * * * of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. * * *

(3) *Sale of land with unharvested crop.* In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted as described in paragraph (2)) at the same time and to the same person, the crop shall be considered as 'property used in the trade or business.'

26 U.S.C. 1952 ed., Sec. 117, now §1231 (4) of Revenue Code of 1954.

Treasury Regulations 111, promulgated under Internal Revenue Code of 1939:

Sec. 29.117-7 [as amended by T.D. 5980, 1953—1 Cum. Bull 63].

(d) *Unharvested crops.* The conditions referred to in (a) (1) (v) above are: (1) the unharvested crop is on land which is 'section 117

(j) property', as defined in (a) (3) above, and such land has been held for more than six months; (2) such crop and such land are sold, exchanged, or converted at the same time and to the same person; and (3) no right or option is retained by the taxpayer, at the time of the sale, exchange, or conversion, to reacquire, directly or indirectly, the land (other than one customarily incident to a mortgage or other security transaction). The length of time for which the crop, as distinguished from the land, has been held is immaterial. *A leasehold or estate for years is not 'land' for the purpose of this section.**

CONGRESSIONAL COMMENTS

S. Rep. No. 781, Part. 2, 82d Cong., 1st Sess., pp. 42-43 (1951-2 Cum. Bull. 545, 574):

SECTION 323. SALE OF LAND WITH UNHARVESTED CROP.

This section, for which there is no corresponding provision in the House bill, amends section 117 (j) of the code (relating to sale, exchange, or conversion of property used in the trade or business) to provide that, under certain conditions, an unharvested crop shall be considered as property used in the trade or business. Whether gain or loss from the sale, exchange, or conversion of such a crop will, as a result of this amendment, be treated as gain or loss from the sale or exchange of a capital asset held for more than 6 months will depend upon the application of section 117 (j) to that and other transactions of the taxpayer.

* * * * * *

*Emphasis ours.

Subsection (a) (2) adds a new paragraph (3) to section 117 (j) to provide that when an unharvested crop on land used in the trade or business and held for more than 6 months is sold or exchanged (or compulsorily or involuntarily converted as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) with such land and at the same time and to the same person, such crop shall be considered as 'property used in the trade or business.' The length of time for which the crop, as distinguished from the land, has been held is immaterial.

* * * * * * *

The report of the Senate Committee was accepted by the House in the Conference Report:

"This amendment provides rules for the application of Section 117 (j) in cases where land bearing an unharvested crop is sold. The provision applies in cases where the land has been held for more than 6 months. The period that the crop has been on the land is immaterial. The House recedes."

Comments by Senator Humphrey on the Senate Floor September 21, 1951, recorded in Volume 97, Congressional Record, Part 9, at page 11811:

"The farmer who disposes of property used in his business should not be taxed differently from the manufacturer or merchant who does the same thing."

Senator Holland on September 28, 1951, Congressional Record, Volume 97, at page 12376:

"The result of the amendment is to make uniform this matter and to give a fair deal to our agricultural people all over the nation.

I call attention to the fact, Mr. President, that this is a matter which does not generally concern the very rich people. This is something that applies to the farmers, small and large, who will be permitted to sell their properties now with security, whereas they have been denied that security under the law as it is now mistakenly enforced."

STATEMENT OF THE CASE.

This action is for a refund of corporation income taxes paid for the fiscal year ending April 30, 1952, in the amount of $107,258.90 with interest thereon as provided by law.

Plaintiff corporation was lessee of several parcels of land which were used to grow a variety of crops such as hay, cotton, seed alfalfa, et cetera. The leased lands had been under lease to the plaintiff for a period in excess of six months at the time the question presented in this action arose.

During the fiscal year ending April 30, 1952, plaintiff sold its farm leases together with the unharvested crops on said lands at the same time and to the same person, to-wit, Wheeler Farms, a partnership. Plaintiff also sold its harvested crops to said partnership at the same time. [18, 19]

In its Federal income tax return for said fiscal year plaintiff reported the sale of its leases and the

unharvested crops as a single transaction and treated the entire gain from said sale as a long term capital gain. [16]

Thereafter the Commissioner of Internal Revenue assessed a deficiency in the amount of $107,258.90 against the plaintiff. Said deficiency resulted from the Commissioner's disallowance of capital gain treatment on that portion of the gain resulting from the sale of the unharvested crop on the leased land.

Of the above sales, the sale of the harvested crop in the amount of $87,000.00 was reported as ordinary income. The gain on the sale of the farm leases, in the amount of $244,925.73 and the gain on the sale of the growing crops, in the amount of $237,954.56, were reported as gain from the sale of capital assets.

Ordinary income treatment on the sale of the harvested crop and capital gain treatment on the sale of the farm leases were accepted by the Commissioner of Internal Revenue as reported by plaintiff. However, capital gain treatment, under Section 117 (j) (3) of the Internal Revenue Code of 1939, applied by plaintiff to the gain from the sale of the growing crop was disallowed, upon the ground that said gain from the sale of the growing crop upon the leased land must be treated as ordinary income.

The District Court had jurisdiction by virtue of the provisions of Title 28, U.S.C.A., Section 1346 (a) (1) and Title 26, U.S.C.A., Section 7422, [16] since it involves a claim for refund of income taxes paid under protest after a deficiency assessment by the

District Director, United States Treasury Department, Internal Revenue Service, R. A. Riddell.

Formal judgment was signed and entered January 9, 1958. [25]

A timely notice of appeal was served and filed February 13, 1958, [36] and the formal record docketed March 26, 1958 in the Ninth Circuit Court of Appeals. [37]

Designation of Points on Appeal and Designation of Record to be printed was filed in the Circuit Court on April 5, 1958 [39].

REASONS FOR GRANTING WRIT.

1.

The Circuit Court of Appeals has decided an important question of federal law which has not been, but should be, settled by this Court.

2.

The Circuit Court of Appeals has departed from the accepted and usual course of judicial proceedings and has sanctioned such a departure by the lower Court in the following particulars:

(a) In deviating from the commonly accepted rule of statutory construction which requires all parts of a statute to be considered in relation to each other;

(b) In singling out certain words in a statute to the exclusion of others;

(c) Injecting a meaning into a statute contrary to the express language of the statute in question; and

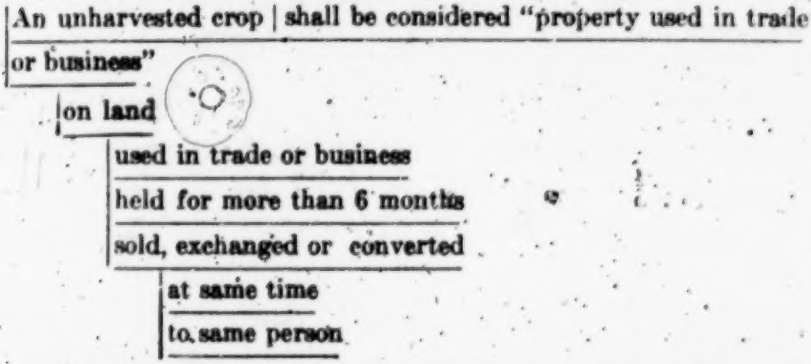
(d) In ignoring the mandate of the United States Constitution, Article I, Section 8, subdivision (1), which requires taxes, duties, imposts and excises to be uniform throughout the United States.

ARGUMENT.

POINT I.

THE RULING IS CONTRARY TO THE EXPRESS LANGUAGE OF THE STATUTE.

The true meaning of the statute may be readily grasped by grammatically diagraming Sections 117 (j) (3), which is one sentence:



The subject of the sentence is "crop". It is modified by the adjective "unharvested" and the adjective phrase "on land". The word "land" is modified by the adjective phrases: (1) "used in trade or business"; (2) "held more than six months"; and (3) "if crop and land are sold, exchanged or converted, and the sale, exchange or conversion takes place [1] at the same time and is [2] to the same person".

The predicate of the sentence is "shall be considered as 'property used in the trade or business' ".

There is nothing in the statute which specifies any particular method of "holding land". There is no magic in the word "sale" which requires any specific degree of ownership. On the contrary, property in any form, including real property held by any form of land tenure, can be the subject of a sale. For a sale is nothing more than the transfer of a right of possession for a price.

In a word, the statute by its clear and express language expressly includes sales of land held under any form of land tenure for more than six months.

The opinions of the Circuit Court and the District Court ignore the definition of "land" which has been used from time immemorial: The solid substance of the earth as distinguished from water and air. They, in effect, inject into the definition a particular type of an estate in land to the exclusion of others, namely, a fee title. This may not be done because the word "land" has no such commonly accepted meaning.

Furthermore, a contrary intent appears in the language of the statute itself, in the following language:

> "an unharvested crop on land *used* in the trade or business and *held for more than 6 months*, . . ."

A leasehold estate in land is one of many forms of land tenure under which land is held. By failing to exclude certain forms of land tenure the conclusion is inescapable that all forms of land tenure of

more than 6 months duration were intended to be included by the use of the phrase "used in the trade or business and held for more than 6 months" in the statute.

Mertens, Law of Federal Income Taxation, Volume 1, page 20, states:

> "The legislative intent is to be drawn from the whole statute so that a consistent interpretation can be reached and no part shall perish or be allowed to defeat another. No provision of a statute stands alone but each must be read with the others bearing upon it."

Mertens, supra, Volume 1, page 5, further states:

> "The duty of the Courts is limited to interpretation. They cannot legislate."

The inconsistency of the construction given by the Department of Internal Revenue and the Court below is brought into sharp focus by reason of the fact that in the return the sale of the lessee's estate in the land was recognized as a capital gain, because it was "land used in the trade or business and held for more than 6 months". It is well settled that leasehold estates in land are subject to sale and the transactions are taxable. *Sutliff v. Commissioner,* 46 B.T.A. 466; *Golensky v. Commissioner;* 200 Fed. 2d 72.

POINT 2.

THE REGULATION OF THE TREASURY DEPARTMENT IS VOID.

The Treasury regulation 29.117-7 as amended by TD-5980, 1953-1 CUM.BULL. 63 attempts to inter-

pret the amendment which added Section 117 J. 3 to the code, and in so doing concluded, "a leasehold and estate for years is not 'land' for the purpose of this section". For the first time the subject of land tenure was injected into the picture by this regulation adopted some three years after the effective date of the act which added the section to the code. It is directly contrary to the express definition of "land" contained in the act itself, which is, "land used in the trade or business and held for more than 6 months". There is no exclusion of land held by leasehold tenure in the language of the act, and in making this injection the Treasury Department ruling is not only legislating, but legislating directly contrary to the express provision of the rule enacted by Congress.

The rule is well settled that where an executive department is authorized to make rules of procedure the rules so made are subject to the requirement that they enforce the spirit of congressional legislation, and when they fail to do so or are contrary to the express congressional intent they are void. *Hagger v. Helvering,* 308 U. S. 389, 60 Sup. Ct. 337 (1940), 54 Harvard Law Review 377; *Sanford v. Commissioner,* 308 U. S. 39, at 53 (1939), 84 L. Ed. 20; *Barnett v. Chicago Portrait,* 285 U. S. 1, at 16 (1932); *Dragoon v. U.S.A.,* 144 Fed. Sup. 188 (1957); *Scofield v. Lewis,* 251 Fed. Rep. 2d 128.

POINT 3.

THE PROBLEM HAS NEVER BEEN PASSED UPON BY THIS COURT.

No case has yet reached this Court dealing with the problem created by the amendment. One case, however, has commented upon the amendment while dealing with a problem which arose before the amendment. In *Watson v. Commissioner*, 345 U.S. 545, at 557; 73 Sup. Ct. Rep. 849 at 855; 97 Law Ed. 1232, on page 1243, Justice Minton states:

> "In amending the Revenue Act of 1951 Congress took cognizance of the construction placed upon Section 117 (j) (1) by the Commissioner and the Tax Court and amended the section to make it abundantly clear that unharvested crops were a part of the land upon which they were grown and were to be given special capital gains treatment."

And, further:

> "Congress was correcting a misinterpretation of the Revenue Act by the Commissioner and the Tax Court."

The majority opinion notes (345 U.S. 548, 73 Sup. Ct. Rep. 851):

> "The issue before us turns upon the acts of Congress. In 1951, Congress, for the first time, dealt expressly and specifically with this subject. While that action was prospective only its terms throw light upon the problems of prior years. The adoption of that amendment emphasized the point that the question was one of federal law. Its adoption also recognized that in order for such income to be a capital gain an affirmative statement by

Congress was needed. Finally, it not only permitted proceeds of unharvested crops to be treated as capital gains under certain circumstances but it provided that, under those circumstances, the taxpayer could not deduct from his taxable income the expenses attributable to the production of the unharvested crop. Those expenses thereafter must be treated as capital investments added to the basis of the property to which they relate."

The strong implication from the *Watson* case, which comes from the language above noted, is that since Congress has, by affirmative statement, characterized unharvested crops on land held for more than 6 months and used in the trade or business as property used in the trade or business, it is the duty of the Treasury Department and the Courts below, and this Court, to follow the mandate of Congress.

Smith v. Cole, 218 Fed. Rep. 2d 667, decided by the 9th Circuit in 1955, also dealt with the Act before the amendment. It noted but did not construe the amendment.

While not discussing the specific section of 117 (j), here involved, the case of *Albright v. U. S. A.,* 173 Fed. 2d 339 (8th Circuit) is directly contrary to the case at bar in its attitude and approach. In applying Section 117 (j) the following pertinent language appears:

"Section 117 (j) was intended as a relief measure applicable alike to all taxpayers within its provisions. *Leland Hazard v. Commissioner,* 17 T.C. 372. That it was so intended is clearly ex-

> pressed in the report of the Committees of the House of Representatives and of the Senate in charge of the bill. . . . The section provided an entirely new method of reporting gains and losses on the sale of noncapital assets used in the trade or business of the taxpayer. The amendment permits the taxpayer to deduct in full the net loss resulting from transactions within the purview of the section and to report net gain only up to the extent of 50 per cent. Nothing in the language of the Act indicated an intention on the part of Congress to deny the relief granted by the section to any taxpayers whose transactions met the prescribed conditions."

Judgment in favor of the Government's contention that a sale of breeding stock was ordinary income was reversed with directions.

The case of *Cook v. U. S. A.*, 165 Fed. Supp. 212, decided by District Judge Donovan, August 22, 1958, follows the reasoning of *Albright* and contains the following persuasive language:

> "Section 117 (j) (1) is a relief measure available to all taxpayers whose transactions meet the prescribed conditions. The statute is not ambiguous; the Congressional intent is clear; and the rulings of the Treasury Department which purport to construe the statute are to be disregarded when their effect is to deny capital gains treatment to a taxpayer otherwise within the statute."

Thus there is an inconsistency in the attitude adopted by the 9th Circuit as opposed to the 8th Circuit which should be corrected by this court.

POINT 4.

THE PROBLEM IS ONE OF WIDESPREAD GENERAL INTEREST.

In 1954 there were 4,783,021 farms in the United States covering 1,160,043,854 acres of tillable land.

Of the farms before mentioned, 2,744,708 farms were operated by fee owners; 868,180 by "part owners"; 20,894 by managers; and 1,149,239 by tenants.

Of the acreages farmed 397,214,478 acres were farmed by fee owners; 472,464,635 by part owners; 100,002,885 by managers; and 190,361,856 by tenants.

For the purposes of the problem before us part owners and tenants would be given ordinary income treatment, and fee owners capital gains treatment, under the Government's position. Percentagewise approximately 65% of unharvested crops sold with the land would be denied capital gains treatment, with the result that the Congressional Act would become a farce, because it would apply only to approximately 34.2% of those intended to be covered. (Authority: Agricultural Census of 1954, compiled by the Secretary of Agriculture.)

There is no logical reason for this segregation. The taxpayer's business is that of farming. Farming is conducted in the same manner upon fee land as it is upon leased land. It is the business of raising and selling crops. When a farmer goes out of business he sells everything for one lump sum, regardless of whether the price is paid for fee land or leased land with an unharvested crop growing upon it. It is not

the usual method by which a farmer disposes of his crop, which ordinarily is in quantities far less than the whole crop, and to many customers, according to the market and price.

Though neither the opinion of the Circuit Court nor that of the District Court affirmatively so states, two reasons appear in the background as the basis for their conclusion. The first is an unconscious desire to assist the Department of Internal Revenue in collecting a maximum amount of taxes. This reason, although admirable in principle, is not a justification for failing to follow the express mandate of Congress.

The second reason is a fear that by some possible method of manipulation as yet not foreseen all farmers might conceivably place themselves in a position to claim capital gains rather than ordinary income treatment for the sale of their crops. The answer to this proposition is two-fold: First, both the District Court and the Circuit Court admit the instant transaction to be bona fide. The second answer is that under the express language of the statute farmers could not continue to indulge in the practice because then they would be dealing with land and unharvested crops in the ordinary course of business. As a real estate subdivider who holds lots for sale, they would then become subject to ordinary income treatment under another applicable section of the Internal Revenue Code. More basic, however, is the fact that under the language of the statute itself it can only apply to the last "sell-out" sale, after which the farmer is out of business.

POINT 5.

THE CONSTRUCTION ADOPTED BY THE DEPARTMENT OF INTERNAL REVENUE AND THE COURTS BELOW IS DISCRIMINATORY AND UNCONSTITUTIONAL.

Article I, Section 8, subdivision (1) of the Constitution of the United States requires all taxes, duties, imposts and excises to be uniform. The result here reached is a total disregard of uniformity in the taxation of unharvested crops. 60% plus of the crops grown are grown on farms the title to which, or a portion of the farm, is held under lease tenure. These crops are grown, handled, and are required to meet the same standards of crops grown on fee lands. Yet a special privilege is extended to fee landowners to the detriment of farms operating under land tenure; and yet the whole purpose of Section 117 (j) (3) was to extend to the farmer who goes out of business and sells his farm and the crops special consideration.

As stated in *Corn Products v. Commissioner,* 1955, 350 U.S. 46:

> "The preferential treatment provided by §117 applies to transactions in property which are not the normal source of business income. It was intended 'to relieve the taxpayer from . . . excessive burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.'"

The same consideration which makes the sale of a fee owned farm a transaction out of the normal course of business would apply to the sale of a leasehold estate together with the crop.

CONCLUSION.

For the foregoing reasons it is respectfully submitted that this petition should be granted.

Dated, Bakersfield, California,
March 30, 1959.

CALVIN H. CONRON, JR.,
W. E. JAMES,
By CALVIN H. CONRON, JR.,
Attorneys for Petitioner.

(Appendix Follows.)

Appendix

EXHIBIT A

United States Court of Appeals
for the Ninth Circuit

BIDART BROS., a corporation, *Appellant*, vs. UNITED STATES OF AMERICA, *Appellee*.	No. 15,950 Jan. 7, 1959

Appeal from the United States District Court for the Southern District of California, Northern Division

Before: FEE, BARNES and HAMLIN, Circuit Judges

BARNES, Circuit Judge:

This is an appeal from a decision rendered against the taxpayer on his cause of action seeking a refund for income taxes paid under protest. 28 U.S.C. § 1346(a)(1); Int. Rev. Code of 1954, § 7422. It covers the period May 1, 1951, to April 30, 1952. Appellant sold growing crops on leased land. The land had been leased for more than six months. Plaintiff sold the

growing crops and the lease to the same party in one transaction and returned the profit as long term capital gain. The Commissioner accepted the taxpayer's return showing capital gain on the sale of the farm leases; accepted the taxpayer's return listing as ordinary income the proceeds of the sale of harvested crops on the leased land, but refused to accept the taxpayer's treatment of the proceeds of unharvested crops on leased land as capital gain. The Commissioner determined the deficiency; the taxpayer paid it; claimed a refund; and, when the claim was rejected, filed this action below.

Section 117(j)(3) of the Int. Rev. Code of 1939 provides:

> "In the case of an unharvested crop on *land* used in the trade or business and held for more than 6 months, if the crop and the *land* are sold or exchanged . . . at the same time and to the same person, the crop shall be considered as 'property used in the trade or business.'"

Int. Rev. Code of 1939 as amended by ch. 521, § 323 (a)(2), 65 Stat. 500.

The word *"land"* above is emphasized because of its interpretation by the Government under Treasury Regulations 111, promulgated under the Int. Rev. Code of 1939, § 29.117-7, which concludes with the words: "A leasehold of estate for years is not 'land' for the purpose of this section."

Following the regulation interpreting the statute, the Commissioner held the proceeds of unharvested crops were taxable as ordinary income, because, while

all other prerequisites of § 117(j)(3) had been met, the unharvested crops were on a "leasehold" and not on "land."

The sole legal question is whether the net profit from the sale of such crops must be taxed as ordinary income or as capital gain. The subsidiary question is whether a "leasehold" is "land," as that term is used in the statute. The district court held it was not.

The case was tried below on a written stipulation of facts. Thus factual issues do not exist.

The district court carefully discussed the Tax Court cases which had first met this issue,[1] and how, after the 1951 amendment adding paragraph three to subsection "j" of section 117 of the 1939 Code, the tax cases were reviewed by the fifth, tenth and ninth circuits[2] and by the Supreme Court.[3] But no cases were found on the precise question here involved, *i.e.*, is a leasehold "land"?

A discussion of the precise language used in the statute followed in the district court's opinion, and the lack of any definition therein was considered. In

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[1] *Watson v. Comm'r*, 1950, 15 T.C. 800; *McCoy v. Comm'r*, 1950, 15 T.C. 828; *Owen v. Comm'r*, P-H. Tax Ct. Mem. Dec. ¶ 50300.

[2] *Watson v. Comm'r*, 9 Cir. 1952, 197 F.2d 56; *Owen v. Comm'r*, 5 Cir. 1951, 192 F.2d 1006; *McCoy v. Comm'r*, 10 Cir. 1951, 192 F.2d 486.

[3] *Watson v. Comm'r*, 1953, 345 U.S. 544. See also, Dakin, The Capital Gains Treasure Chest: Rational Extension or Expedient Distortion?, 14 La. L. Rev. 505, 516 (1954); Halstead, Sales of Land With Growing Crops—Tax Treatment, 31 Taxes 55 (1953); Hill, Ordinary Income or Capital Gain on the Sale of an Orange Grove?, 4 Miami L.Q. 145 (1950); Comment, Farmers and the Federal Income Tax, 19 U. Chi. L. Rev. 522, 530 (1952).

view of such lack of definition in the Revenue Act itself, the district court discussed the law of California, the state in which the problem arose, and concluded that leases or estates for years do not come within the term "land."[4] However, the Supreme Court has held the state definition of "land" is immaterial, *Watson v. Comm'r*, 1953, 345 U.S. 544, 551, stating: "Whether or not the crop be real property, the federal income tax upon the gain resulting from the sale is, in its nature, a subject of federal law."

The district court then examined Senate and House reports, and the congressional debates, and found nothing which caused it to change its view as to the plain meaning of the statute.

We are in agreement with the trial court. It may be argued that when Congress enacted § 117(j)(3) in 1951, it intended to refer to "unharvested crops on land or leaseholds used . . . and held . . ." etc. But it did not say so. It said "on land." Had it intended to apply to crops on land, whether fee or leasehold, it would have been an easy thing to have said so. Or it could have granted the farmer capital gain treatment on all crops; or all unharvested crops, had this been its intention. But it enacted a law, not applicable to all unharvested crops sold, but only on unharvested crops on land held more than six months, and sold or exchanged at the same time and to the same person.

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[4] *Kreling v. Walsh*, 1947, 77 Cal.App.2d 821, 832, 176 P.2d 965. See also, *Dabney v. Edwards*, 1935, 5 Cal.2d 1, 53 P.2d 962; *Potts Drug Co. v. Benedict*, 1909, 156 Cal. 322, 104 Pac. 432.

Appellant earnestly urges that the lower court's decision interprets "land" to mean "fee land"; that this is adding to the statute, which courts may not do—they may interpret, but not legislate. Whether we rule that the term "land" *excludes* leaseholds, as the government urges, or *includes* leaseholds, as appellant urges, it seems to us we are asked to do precisely the same thing, *i.e.,* interpret the word used. Each side asserts the term, as used in the statute and undefined therein, must be interpreted; but each in its way and to its own advantage.

Appellant likewise emphasizes the "hardship, injustice, confusion, contradiction, absurdity and wholly unreasonable result" because of the district court's decision, putting tenant farmers in one category and fee land farmers in another.

In interpreting, which we feel we must do in any event, we are constrained to keep in mind several things. The first is that capital gain tax treatment is not a matter of right, but of legislative grace. The Congress provides for it, and however little or much relief is given from taxes payable on ordinary income, the taxpayer must accept. As the district court said: "If inequities exist, such inequities must be corrected by Congress and not by judicial legislation."

The second factor we must remember is that the Supreme Court has told us that "in order for such income (unmatured crops) to be a capital gain, an affirmative statement by Congress was needed." *Watson v. Comm'r, supra* at 548.

The somewhat analogous matter of whether gains from hedging transactions could be considered by the taxpayer as capital gain rather than ordinary income was before the Supreme Court in *Corn Products v. Comm'r,* 1955, 350 U.S. 46. That case involves commodities and not land, but does interpret § 117 of the Int. Rev. Code of 1939. The Court there said:

> "[T]he capital-asset provision of § 117 must not be so broadly applied as to defeat rather than further the purpose of Congress. *Burnet v. Harmel,* 287 U.S. 103, 108. Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended 'to relieve the taxpayer from . . . excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions.' *Burnet v. Harmel,* 287 U.S., at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term 'capital assets' in § 117. See *Hort v. Commissioner,* 313 U.S. 28, 31; *Kieselbach v. Commissioner,* 317 U.S. 399, 403."

Surely the net proceeds of the sale of a farmer's harvested crops ordinarily are ordinary income. Did Congress without question intend to permit the sale

of unharvested crops growing on any leasehold, and no matter what the value of that leasehold might be as compared to the value of the crops themselves, and whether the sale occurs a day or a week or a month before harvest time, to change ordinary income to capital gain? Did Congress intend to permit a farmer, if he wills, to change ordinary income into a capital gain by a simple contractual transaction? We think not.

We recognize in this case, as the trial court also recognized, that the sale was made in good faith; the leases had several years to run; and appellants were retiring from the farming business. Furthermore, the amount received for the leases was *more* than the on the sale of the growing crops.[5] Yet (and this is the third factor we must keep in mind) we must consider the general effect of any interpretation here enunciated, as well as the consequences of the interpretation in the specific matter before us.[6]

As to the claimed "unfairness" existing in the peculiar circumstances of this case, the farmer who sells his unharvested crop when he sells his land held in fee simple, but has held it *less* than six months, is

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[5]Gain on farm leases, $244,925.73; gain on sale of growing crops, $237,954.56.

[6]Suppose two farmers owing comparable adjoining 40 acre tracts, each growing the same crop, should each lease his field to his neighbor, and sell the unharvested crops, plus the leasehold, each to the other, or both to a third farmer, just before harvest. Could the Congress have intended to permit such a transaction to convert ordinary income to capital gain? If so, would it not have been simpler to exempt all farmers from payment of taxes on ordinary income from farming operations, and merely tax farmers on a capital gain basis?

also treated "unfairly" in comparison to the same farmer who has held it *more* than six months. And so is the farmer who sells his unharvested crop to one person and his fee simple land to another person, even though the land has been held *more* than six months. Yet in both cases his claim of unfairness rests on his failure to bring his transaction within the provisions of the statute, which the Congress, in its wisdom, has seen fit to make the law of this land.

There are many reasons in equity why this appellant should be entitled to receive the same tax treatment on the sale of growing crops on "leased land" as the taxpayer who sells growing crops on "land" he owns outright. But the Congress, in exercising its grace, has not yet clearly gotten around to accomplishing that. And we cannot do it for the Congress.

The judgment of the district court is *affirmed*.

(Endorsed:) Opinion. Filed Jan. 7, 1959.
Paul P. O'Brien, Clerk.

EXHIBIT B

[Title of District Court and Cause.]

ORDER

This action is for a refund of corporation income taxes paid for the fiscal year ending April 30, 1952, in the amount of $107,258.90 with interest thereon as provided by law.

Plaintiff corporation was lessee of several parcels of land which were used to grow a variety of crops such as hay, cotton, seed alfalfa, et cetera. The leased lands had been under lease to the plaintiff for a period in excess of six months at the time the question presented in this action arose.

During the fiscal year ending April 30, 1952, plaintiff sold its farm leases together with the unharvested crops on said lands at the same time and to the same person, to-wit, Wheeler Farms, a partnership. Plaintiff also sold its harvested crops to said partnership at the same time.

In its Federal income tax return for said fiscal year plaintiff reported the sale of its leases and the unharvested crops as a single transaction and treated the entire gain from said sale as a long term capital gain.

Thereafter the Commissioner of Internal Revenue assessed a deficiency in the amount of $107,258.90 against the plaintiff. Said deficiency resulted from the Commissioner's disallowance of capital gain treatment on that portion of the gain

resulting from the sale of the unharvested crop on the leased land.

Of the above sales, the sale of the harvested crop in the amount of $87,000.00 was reported as ordinary income. The gain on the sale of the farm leases, in the amount of $244,925.73 and the gain on the sale of the growing crops, in the amount of $237,954.56 were reported as gain from the sale of capital assets.

Ordinary income treatment on the sale of the harvested crop and capital gain treatment on the sale of the farm leases were accepted by the Commissioner of Internal Revenue as reported by plaintiff. However, capital gain treatment, under Section 117 (j) (3) of the Internal Revenue Code of 1939, applied by plaintiff to the gain from the sale of the growing crop was disallowed, upon the ground that said gain from the sale of the growing crop upon the leased land must be treated as ordinary income.

The case came on for trial before the Court sitting without a jury on November 27, 1957. The plaintiff was represented by Conron, Heard and James, Calvin H. Conron, Jr. appearing. The defendant was represented by Laughlin E. Waters, United States Attorney, John G. Messer, Assistant United States Attorney, appearing.

The case was tried on a pre-trial order based upon a written stipulation of facts. The only question presented in this case is whether the taxpayer

corporation, having sold long-term leases on land with growing crops thereon, at the same time and to the same person, is entitled to capital gain treatment on the gain realized from the sale of the growing crops under Section 117 (j) (3) of the 1939 Internal Revenue Code.

Section 323 of the Internal Revenue Code of 1951 added paragraph 3 to subsection "j" of Section 117 of the 1939 Internal Revenue Code and was made applicable with respect to sales, exchanges and conversions occurring in taxable years beginning after December 31, 1950.

Said paragraph 3 provides as follows:

"Sale of Land with Unharvested Crop.—In the case of an unharvested crop on land used in the trade or business and held for more than 6 months, if the crop and the land are sold or exchanged (or compulsorily or involuntarily converted as described in paragraph (2) at the same time and to the same person, the crop shall be considered as 'property used in the trade or business.'"

After the amendment adding said paragraph 3, the Treasury Department promulgated a regulation which reads in part as follows:

"(a) In General

"(1) Section 117 (j) provides that the recognized gains and losses, described below shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months.

"(v) Gains and losses from the sale, exchange, or involuntary conversion in a taxable year beginning after December 31, 1950, of an unharvested crop under the conditions specified in (d) hereof.

"d) Unharvested crops.—The conditions referred to in (a) (1) (v) above are: (1) the unharvested crop is on land which is 'section 117(j) property' as defined in (a) (3) above, and such land has been held for more than six months; (2) such crop and such land are sold, exchanged or converted at the same time and to the same person; (3) no right or option is retained by the taxpayer, at the time of the sale, exchange or conversion, to re-acquire, directly or indirectly, the land. The length of time for which the crop, as distinguished from the land, has been held is immaterial. A leasehold or estate for years is not 'land' for the purpose of this section." (Section 29.117-7 of Regulations 111, as amended by Treasury Decision 5980, Cum. Bull. 1953-1, 65.)

Prior to said amendment adding paragraph 3, the policy of the Commissioner of Internal Revenue regarding tax treatment of sales of growing crops was to the effect that any gain realized from the sale of growing crops was ordinary income, regardless of their stage of development. (1946 Cumm. Bull. 31). The Tax Court, in several decisions, sustained the views of the Commissioner. (Watson v. Commissioner, 15 T.C. 800; with two judges dissenting; McCoy v. Commissioner, 15 T.C. 828; Owens v. Commissioner, P-H- TC. Memo, par. 50.300). There were decisions

of the District Courts to the contrary. These conflicting decisions were called to the attention of Congress, culminating in the amendment adding paragraph 3.

Subsequent to the amendment, Owens v. Commissioner was reversed on appeal (192 Fed. 2d 1006, Fifth Circuit); McCoy v. Commissioner was reversed on appeal (192 Fed. 2d 486, Tenth Circuit) and Watson v. Commissioner was sustained on appeal (197 Fed. 2d 56, Ninth Circuit). This conflict was resolved by the Supreme Court of the United States when the Watson decision was affirmed in 1953 (345 U.S. 544). In the McCoy case, the Tenth Circuit held that the gain realized from the sale of land together with a wheat crop growing thereon was entitled to capital gain treatment. In the Owens case, the Fifth Circuit held that the gain from the sale of an orange grove with an unharvested crop growing thereon was entitled to capital gain treatment. In the Watson case, the Ninth Circuit held that the gain from the sale of an orange grove with a growing crop thereon was subject to segregation and that the proceeds attributable to the land were entitled to capital gain treatment, while the proceeds attributable to the crop must be reported as ordinary income.

There can be no question that if the corporate taxpayer had owned for more than 6 months the land upon which the crops were growing, and had sold the same together with the unharvested crops in the same manner that he sold the leases with the growing crops, the profits of such sale would have received capital gain treatment. In the instant case, the corporate tax-

payer received capital gain treatment on that part of the proceeds of the sale realized from the sale of the leases. Such treatment appears to be proper. (Sutliff v. Commissioner, 46 BTA 446; Golonsky v. Commissioner, 200 Fed. 2d 72, cert. den. 345 U.S. 939.)

The plaintiff contends that the regulation of the Commissioner is contrary to the plain language of said paragraph 3, and contrary to Congressional intent. It is the position of the defendant that said paragraph 3 is clear and that the regulation is simply declaratory of the intent of Congress.

I have been unable to find any decision rendered by any United States court which considered the tax treatment which should be accorded to the gain realized from the sale of an unharvested crop which was growing on land held under lease or an estate for years, and in which a sale was made of the lease or estate for years together with the crop to the same purchaser in the same transaction.

The problem, therefore, is to determine the meaning which Congress intended to give to the word "land" as it appears in paragraph 3. The regulation promulgated by the Treasury Department states that in using the word "land", Congress did not intend such meaning to cover "a leasehold or estate for years". Counsel for the plaintiff argues with great earnestness that Congress in enacting paragraph 3 was concerned only with land tenure or use, and not land ownership. It is to be noted that the words "land tenure", "land use", "use of land", "lease", "real property" or similar

expressions do not appear in the statute. The critical phrase in the statute is "if the crop and the land are sold * * *". The word "land" is not defined in the Revenue Act. Generally speaking, the language of the Revenue Act, just as in any statute, is to be given its ordinary meaning. (Helvering v. William Flaccus Oak Leather Company, 313 U.S. 247.) In the absence of a definition of a word in the Revenue Act, resort may be had to the definition contained in the law of the State in which the problem arises for the purpose of ascertaining the meaning of such word. (Watson v. Commissioner, 345 U.S. 544.)

The ordinary meaning of the word "land" and the definition of "land" under the law of the State of California are the same.

Webster's New International Dictionary, 2d edition, defines land as "the solid part of the surface of the earth as distinguished from water constituting a part of such surface". Black's Law Dictionary, 4th edition (1951) states that "Land, in the most general sense, comprehends any grounds, soil, or earth whatsoever; as meadows, pastures, woods, moors, waters, marshes, furzes and heath. Co. Litt. 4a". Section 659 of the California Civil Code states that "Land is the solid material of the earth, whatever may be the ingredients of which it is composed, whether soil, rock or other substance."

The following citations from the State of California indicate that leases or estates for years do not come within the term "land": In Kreling v. Walsh, 77 C.A. 2d 821 (rehearing denied by the Supreme Court) the

Court said at page 832, "The lease herein, being for a specified term of years, is a chattel real, is personal property, and consequently is not real property or real estate. (Jeffe[illegible] v. Easton, Eldridge & Co. 113 Cal. 345; City of Santa Barbara v. Maher, 25 Cal. App. 2d 325.) Leases for a definite term of years fall within the definition of personal property and are not governed by the rules applicable to real property."

The Supreme Court of California in the case of Dabney v. Edwards, 5 Cal. 2d 1, stated that estates for years at common law were classified as chattels real and regarded as personal property. The Court further stated that such common law definition has been definitely maintained and endorsed by the courts of the State.

In Potts Drug Company v. Benedict, 156 Cal. 322, the subject of a transaction between the parties involved a lease for a term of years. The Court stated at page 327: "Such estate, being one for years, was not real property, but was a chattel real, and, under the law, must be regarded as having been part of the personal estate of plaintiff."

It is my view that the phrase "if the crop and the land are sold" clearly means the ownership of the land and does not mean "if the crop and the right to the use of land are sold", as urged by the plaintiff.

This meaning is not changed by the clause in the statute which reads "in the case of an unharvested crop on land used in the trade or business and held for more than 6 months". That clause is modified by the clause "if the crop and the land are sold".

Notwithstanding my belief that the language of the statute is clear, I have read the Senate Report 781 as it appears in the U. S. Code Congressional and Administrative Service, 82nd Congress, First Session, 1951, at pages 2017 and 2018. This report reads as follows:

"Sales of Land with Unharvested Crops.

Section 117 (j) of the code provides, in effect, that a net gain from sales of properties 'used in the trade or business' of a taxpayer, including 'real property' so used, if held more than 6 months is to be treated as a capital gain. In the case of a net loss, it is treated as an ordinary loss. Where unharvested crops are sold together with the land, or unripe fruit is sold together with the land and the trees, a difficult question has arisen as to the proper application of the present law to the unharvested crops or the unripe fruit.

The Bureau of Internal Revenue has ruled that, whether or not such crops or fruit are regarded as a part of the real estate under local law, they constitute property held 'primarily for sale to customers in the ordinary course of his (the taxpayer's) trade or business' and thus, under the provisions of section 117 (j), any gain on the sale of the unharvested crops or unripe fruit is to be separately determined and treated as ordinary income instead of as capital gain. In several decisions, the Tax Court, (with some members dissenting) has taken a similar view, but two district courts have held that such fruits or crops constitute 'property used in the trade or business' so that a gain from a sale of the land, trees, and fruit would be

treated as a capital gain with the result that the entire gain from the sale of such property would constitute *ordinary income.** (Italics added.)

Your committee believes that sales of land together with growing crops or fruit are not such transactions as occur in the ordinary course of business and should thus result in capital gains rather than in ordinary income. Section 323 of the bill so provides.

Your committee recognizes, however, that when a taxpayer keeps his accounts and makes his returns on the cash receipts and disbursements basis, the expenses of growing the unharvested crop or the unripe fruit will be deducted in full from ordinary income, while the entire proceeds from the sale of the crop, as such, will be viewed as a capital gain. Actually, of course, the true gain in such cases is the difference between that part of the selling price attributable to the crop or fruit and the expenses attributable to its production. Therefore, your committee's bill provides that no deduction shall be allowed which is attributable to the production of such crops or fruit, but that the deductions so disallowed shall be included in the basis of the property for the purpose of computing the capital gain.

The provisions of this section are applicable to sales or other dispositions occurring in taxable years beginning after December 31, 1950.

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*(Apparently a clerical error.)

The report of the Senate Committee was accepted by the House of Representatives in the Conference Report as follows:

"Amendment No. 63: This amendment provides rules for the application of section 117(j) in cases where land bearing an unharvested crop is sold. The provision applies in cases where the land has been held for more than 6 months. The period that the crop has been on the land is immaterial. The House recedes." U.S. Code Congressional and Administrative Service, 82nd Congress, First Session, 1951, page 2134.

The decisions under review by the Senate Committee were the three tax cases mentioned above and probably the District Court decisions in Cole v. Smythe, 96 Fed. Supp. 745, and Irrgang v. Fahs, 94 Fed. Supp. 206. In both of the District Court cases, one in Florida and the other in California, there was involved the sale of lands planted to citrus groves with growing crops thereon. Hence, all of the court decisions considered by the Senate Committee involved the sale of the ownership of lands with growing crops thereon at the time of the sale.

The references to the word "land" in the report appear in such expressions as "where land is sold" and "where land bearing an unharvested crop" and "when it [land] is sold if owned for more than 6 months as property with an unharvested crop on it."

I find nothing in the Committee Report which causes me to change my view as to the plain meaning of the statute.

I have also reviewed those parts of the Congressional debates which are quoted in the briefs of both counsel. It is true, as stated by counsel for the plaintiff, that there are statements by Senator Humphrey to the effect that if capital gain treatment is to be accorded to the sale of land with growing crops thereon, then it should be extended to the live stock people, to the turkey people, to the big farmer and the small farmer, and to the "dirt" farmer and to the "sidewalk" farmer, and to the rich farmer and the poor farmer. However, Congress was not persuaded and merely enacted paragraph 3 to cover the factual situations which brought the problem before Congress. It is my view that if Congress had given any attention to the sale of leases together with growing crops, it, undoubtedly, would have placed reasonable restrictions thereon such as limiting capital gain treatment on the growing crops to instances in which the leases contain a minimum term considerably in excess of 6 months, and in which the term of the lease would not expire for some realistically reasonable period after the sale.

Counsel for the plaintiff urges many cogent reasons why this plaintiff should receive the same tax treatment as the taxpayer who sells land with growing crops thereon. There is no question that the sale was made in good faith, that the leases had several years to run, and that the plaintiff was retiring from the farming business. It is clear that the sale was not made simply to obtain capital gain tax treatment on the growing crops. However, if inequities exist, such

inequities must be corrected by Congress and not by judicial legislation.

Capital gain tax treatment is a matter of legislative grace and is not a matter of right, hence Congress can limit the property to which capital gain treatment will be extended. (Polish Army Veterans v. Commissioner, 236 Fed. 2d 509; McCoy v. Commissioner, 192 Fed. 2d 486.)

For the reasons herein expressed, judgment must be in favor of the defendant and it is so ordered.

Counsel for the defendant is directed to prepare and lodge findings of fact, conclusions of law and form of judgment consistent with the views herein expressed.

The Clerk of this Court is directed to forthwith mail copies of this order and memorandum to all counsel.

Dated: December 26, 1957.

/s/ Gilbert H. Jertberg,
Judge, U. S. District Court.

[Endorsed]: Filed December 26, 1957.